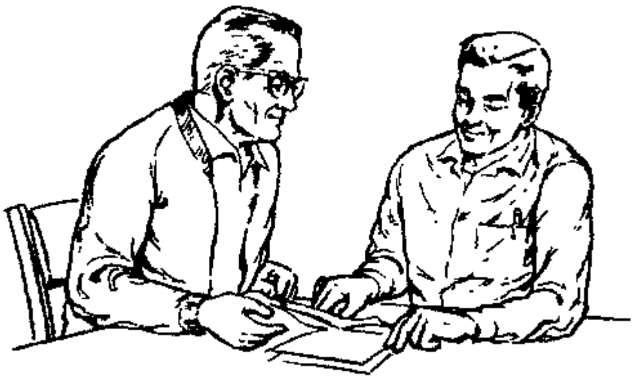

FARM BUSINESS ORGANIZATION a/

CONSIDERATIONS

The farm business generally has a different relationship to the family and to the methods used to control resources involved in the business than most non-farm units. In many cases, the family is much closer to the day-to-day operations and to the strategic short and long time planning decisions.

The traditional philosophy held by farmers has been to gain control of resources by the individual proprietor route as soon as possible. Most non-farm businesses have placed more emphasis on gaining control through multi-ownership (partnerships, incorporations, leasing, renting, etc.)

When a family relationship is closely connected to the business, many problems can develop that were not anticipated in the beginning. The form of business arrangement, whether it be father-son, brother-brother, uncle-nephew, grandfather-son-grandson, or other arrangements, can contribute to many uncertainties unless dedicated planning takes place.

Once a family business arrangement is decided upon, the parties involved must determine the type of operating agreement that best meets the goals of those concerned. The agreement must be effectively carried out and have provisions for adjustment to changing conditions that are certain to occur.

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a/ Prepared by John E. Moore, August, 1974.

CHANGING TENURE, CAPITAL AND LABOR PATTERNS

Capital invested in farmland represents more than two-thirds of the total assets in the farming sector. The control of farm real estate, via ownership or rental, significantly influences income distribution, intergenerational transfer, and farm consolidation.

Trends in Ohio show the percent of farm operators to be decreasing who own all the land they farm, the percent of operators are also decreasing, who own no land and rent all the land they farm, but those who both own and rent are on the increase. In 1969, approximately 35% of the farm acres in Ohio were rented. Of this total, 58% was rented by part owners. Ninety-one percent of the rented acres were owned by non-farm landlords. Table 1 further delineates the tenure situation in Ohio in 1969.

TABLE 1. Percent of Farm Operators in Economic Classes I-V holding farmland in Ohio in the Different Tenure Classes in 1969.

Tenure Class	Percent of Farms Held By	Percent of Farm Land Held By	Percent of Total Market Value of Land and Buildings held By
Full Owner	53.1	38.1	34.1
Part Owner	31.6	45.1	47.1
Full Tenants	15.3	16.8	18.8

Source: Agricultural Economic Report No. 249, USDA, Economic Research Service, February, 1974.

Evidence suggests the majority of the non-farm or non-residence landlords are either retired farmers, members of farm families or closely associated with agriculture through the small rural communities in which they live(1). This suggests the non-resident landlord is an outside investor in the farm business, but is not synonomous with the "Wall Street" type of investor.

Competition in modern farming has forced the rapid adoption of new technology. This in turn resulted in larger size units, increased amounts of inputs purchased off the farm, and greater demands for top-notch production and financial management.

Competent and continuous labor is a key factor in farming. The days of cheap farm labor are over and the competition of nearby industries means farming must offer equal wage opportunities to skilled and competent labor. Higher quality labor is necessary to operate the bigger equipment and more specialized livestock programs.

BIGGER FARMS IN THE FUTURE

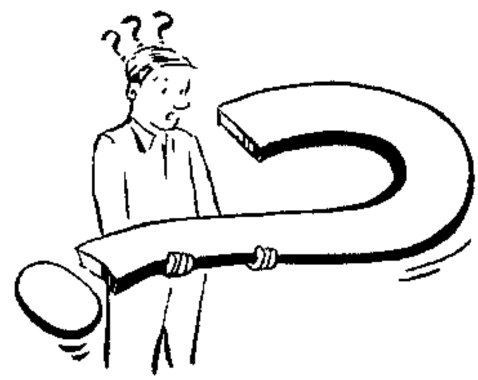
The continuous growth in the size of the farm unit seems essential for success. However, unit efficiency comes first then volume; so larger units will certainly require that managers keep more complete and accurate records for analysis and to use this information in making decisions. As farms become larger, experiences and observations on the farm unit itself will become increasingly more important sources of information.

Size is not necessarily measured in the number of acres farmed, but more logically measured by more gross income or products produced per man. Productivity per man is the key size factor. The family farm will be bigger, more specialized, and more intensified. There may be more contracting or subletting of more of the farming operations to others.

The top farm tenants are making considerably more growth by keeping their money invested in effective operating capital rather than being overly concerned in the ownership of land. However, the sale of land by conditional sales or land contracts has been increasing during the last ten years. This is a way of gaining control with low equity, but it brings some complications for the low equity capital operator.

Estate planning is more critical than a generation ago. It involves more attention on the aspect of gaining control and accumulating capital, covering your risk through adequate insurance, and finally, expediting an inter-generation transfer plan to prevent terrific shrinkage of your life's savings by estate settlement costs.

The type of farm business organization you choose can aid in meeting your resource control objectives as well as your inter-generation transfer needs.



TYPES OF FARM BUSINESS ORGANIZATIONS

Your choice of the type of business organization is a very important decision and should be made only after carefully weighing advantages and disadvantages of all alternatives. Both short and long run planning must be involved to prevent making decisions based on emotion, imitation, or short time advantage in a law. Regardless of how the business is organized, it has to be big enough to productively employ the available labor, management, machinery, etc., for maximum efficiency and for a competitive standard of living for all concerned.

Below are some basic principles to follow in selecting a business organization farm:

1. Each partner or individual involved should be compensated on the basis of his contribution of resources to the business.

2. Manager or managers should plan for minimizing uncertainties and maximizing efficiencies in both the short run and the long run.

3. The organization should provide for a method of obtaining adequate operating capital and ways of gaining control of additional resources most

economically.

4. The income produced by the business should be commensurate with the initial and continuing cost of the organization.

Interest in multi-ownership type of business organization (partnerships, corporations and trusts) is growing in Ohio due to the need a) for more capital, b) for maintaining competent and continuous labor, and c) for lowering overhead costs caused by inadequate use of machinery, buildings, etc.

Sole proprietorship, although not considered as sophisticated as other forms, still has considerable merit under certain conditions and should not be underestimated or overlooked. Each type will be discussed, listing the advantages and disadvantages with specific emphasis on management implications.

A. SOLE PROPRIETORSHIP OR SELF-PROPRIETORSHIP

This type refers to a farmer who owns, manages, assumes all risk and receives all the profit from the business.

Advantages:

1. No cost of organization and easy to form.
2. Fewer government regulations and restrictions generally than on the multi-ownership types.
3. All management decisions rest with the owner.
4. Free to work around the clock or take the day off without consultation or permission from others involved.
5. Planning major and minor changes rests with the owner.
6. Problem of disagreement among owners cannot arise.
7. Financing less complicated and more easily understood.

Disadvantages:

1. Insufficient finances for an efficient business sometimes occurs.
2. Unable to specialize (jack of all trades).

3. Less available time for management decision and analysis than other types of organization.

4. Greater uncertainty about continuation of the business in case of accident or other reasons for becoming incapacitated.

5. Inter-generation transfer generally more difficult.

B. PARTNERSHIP

When two or more persons agree to carry on a business together as co-owners for profit, a business partnership organization is formed.

Advantages:

1. Opportunity to pool capital and management for more efficiency.

2. Aids in solving the problem of the lack of competent and continuous labor.

3. Opportunity for a young farmer to gain control of resources and enter farming.

4. The junior partner can gain in knowledge of production and financial management practices from the senior partner.

5. Opportunity for specialization of management as well as with production skills.

6. Lends itself to partial inter-generation transfer.

7. Opportunity to increase efficiency particularly by lowering overhead costs per unit of production. Machinery and buildings might be used more intensively.

Disadvantages:

1. Need for compatability, mutual respect, and understanding between partners and families.

2. Considerable sacrifice in some cases by father or senior partner of already accumulated resources that could be rented out, then he could take life easier and still have adequate income. However, in some cases the junior

partner and his family sacrifices considerably if no plans are made for them to grow into the business. Partnership in labor only can be a disaster.

3. Partnership sometimes means expansion of the business, borrowing more money, reducing personal expenditures and working more years than senior partner had anticipated.

4. Philosophies of the senior and junior partners sometimes differ as to the amount of debt, risk, and amount money needed to maintain desired standard of living.

5. Death or serious accident sometimes terminates a partnership because of poor planning and nothing in writing.

6. Each partner is fully liable for the other one's actions while in line of business.

7. Many partnerships do not have an adequate insurance program and other legal arrangements designed to meet disasters.

C. INCORPORATIONS

A corporation is an artificial being created under state law. It is a separate business entity distinct from its owners, who are called shareholders because they own shares or interests in the corporation. The major characteristic of the corporate form of business organization is this sharp line of distinction between the business and the owners. The corporation is a separate legal person as well as a separate taxpayer unless shareholders are qualified and elect to be taxed like a partnership known as a Sub Chapter S or Pseudo Corporation.

Advantages:

1. Ease of property transfer or effective vehicle for inter-generation transfer.

2. Pooling of capital and management for improved efficiency.

3. Death does not terminate business in most cases.

4. Provides opportunity for specialization as is case with a partnership.

5. Limited individual liability -- a shareholder is not responsible for debts of the corporation beyond his equity in the corporation, unless he has signed a note as an individual.

6. A corporation may have certain income tax advantages depending on such factors as the income earned, the tax bracket the owners are in and whether the corporation can qualify for Sub Chapter S treatments. Dividends received by a retired worker are considered investment income and do not reduce social security benefits. Also certain employee fringe benefits (such as health and accident insurance) are tax deductible whereas they are not deductible for a sole-proprietor.

Disadvantages:

1. A more formal and complex organization with more reports due quarterly and annually, especially to the Secretary of State's office.

2. Initial costs to establish a corporation are more than for other forms of organization.

3. Additional state taxes: either annual franchise tax of five mills on the net worth or state income tax on net earnings starting at 4 percent, whichever higher.

4. Legal and/or accounting help generally is needed quarterly and annually to assist in filing all reports required.

D. TRUSTS (2)

A trust is a written agreement by which an owner of property transfers his title to a trustee for the benefit of persons called the beneficiaries. The trustee may be a person or persons, a corporation, or a combination of the two. The trust takes over as designated in the trust document. It could be at death (testimentary trust) or during the life of the owner.

Advantages:

1. A trustee(s) may be a better manager than the beneficiaries. This is especially true for minors and inexperienced adults. Many corporate trustees furnish expert management. This applies to both farm land and to funds to be invested in securities.

2. The life of a trust usually lasts for the period provided for in the trust agreement. Death of a trustee or a beneficiary will not terminate the trust unless so provided for in the trust.

Disadvantages:

1. A poor trustee may be selected. Nothing can make up for an incompetent trustee. Therefore, the creator of the trust must exercise sound judgment in the selection. The trustee should be selected on the basis of management ability, honesty and integrity rather than the relationship to the individual if expert management is desired.

SUMMARY

Regardless of the form of business organization the farm decision maker chooses, he must continually evaluate the most profitable method to gain control of machinery, land and other resources. The form of organization can assist in this regard, but renting, leasing, partial partnership, custom hire, and exchange labor and/or machinery may be other resource control possibilities.

There is no one best business organization for all farms. In this day of rapidly increasing costs and appreciation of farm properties one should re-evaluate his type of organization to see if it is meeting the objectives as far as growth; management and labor needs; and income security of parents and family. The children that have agreed to stay on the farm or other children who have contributed substantially to parents' welfare should be compensated for their contribution before equal distribution is made to all children.

A more objective choice in selecting a type of business organization will be made if the long run management implications are studied as well as the specific advantages and disadvantages that may be pertinent to your setup.

There is no substitute for taking the time to plan both in the short and long run. Conserving as much of the gross income as net profit is currently very important, but the sad fact is that too many farmers don't take seriously enough the long run problem of the shrinkage of their estate by settlement costs. Help can be obtained from your area extension farm management agent on becoming more knowledgeable in selecting an appropriate type of business organization and alternatives in the estate planning process.

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